United States Senate

COMMITTEE ON HEALTH, EDUCATION,
LABOR, AND PENSIONS

WASHINGTON, DC 20510-6300

December 10, 1999

Mr. Edmund L. Jenkins
Chairman
Financial Accounting Standards Board
401 Merritt - Seven
Norwalk, CT 06856

Dear Chairman Jenkins:

On September 21, 1999, I held an extensive hearing in the Senate Committee on Health, Education, Labor and Pensions on hybrid and other cash balance pension plans. One issue that was raised by several witnesses was that a conversion of a traditional defined benefit pension plan to a cash balance plan might allow employers to manipulate their financial statements to misrepresent their profitability. This is because the conversion reduced their pension plan's future liabilities and allowed plan sponsors to use excess pension assets to inflate their company profits. Though this limitation of liability and profit "inflation" could apply to traditional defined benefit plans as well as cash balance plans, it appears particularly pronounced in cash balance plan conversions.

Cash balance plans are not *per se,* bad for participants. Yet many conversions have adversely affected older workers with long years of service. Older workers tend to experience a steep decline in the benefits they planned on for their retirement. When the plan is converted, older workers fail to gain from the upward "spike" in the plan's formula that would have dramatically increased their benefits. But because they have not been in the cash balance plan from the beginning, they also do not benefit from the more steady accruals and easy portability that make cash balance plans attractive to mobile and/or young plan participants.

Accounting rules require plan sponsors to reveal pension assets and liabilities as part of their annual statements. FASB began to develop the FAS 87 rule in the early 1980s when a number of seriously underfunded plans were unable to pay promised benefits and dumped their liabilities on the Pension Benefit Guaranty Corporation (PBGC). The intent of the rule was to alert investors to a weakness in a corporation's finances. This is because when underfunded pension plans are terminated, the PBGC has a right to 30 percent of the plan sponsor's net worth or 100 percent of the unfunded vested liabilities of the plan, whichever is greater. Thus, the FAS 87 requirement to carry the value of pension assets and liabilities on a corporation's books has had a beneficial effect in that it has encouraged plan sponsors to fund their plans fully or reveal any liability to their employees, investors and the public.

Many pension sponsors have been prudent stewards of their plan's assets. Investments that were carefully managed and wisely invested resulted in overfunded plans. Rather than looking upon overfunded plans as good protection from plan termination and favorable to participants, many observers are now suggesting that an overfunded plan is a potential threat to the long-term retirement security of the workers. Of course, ERISA and the Internal Revenue Code require that pension assets be held in trust and invested *solely* in the interest of the participants. Fiduciaries who fail to observe these requirements are *personally* liable for any loss to the plan or harm to the plan participants. The only exception to this rule is in limited instances where an overfunded plan may dedicate a portion of its excess assets to payment of *retiree-only* health care benefits in the current year. Thus, these assets and the income they generate are unavailable to corporations for general operational purposes.

The concerns raised at my hearing and in the press center on the fact that swollen pension funds can misrepresent the relation between a pension fund's excess assets and corporate earnings. I know that you are aware of these accounting issues and that they concern policy-makers at the Financial Accounting Standards Board. I would be interested in meeting with you or your staff to obtain your views on this subject, and any information your members might have regarding whether excess assets or pension expenses are being used to misrepresent corporate profits by plan sponsors. If you believe that such misrepresentation is taking place, what steps could FASB take, in the near term or long term? Do you have recommendations for Congressional action?

Should you need additional information, please feel free to contact me or Diann Howland of my staff who can be reached at (202)224-1284.

Sincerely,

Jim Jeffords

James M. Jeffords